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No.

IN THE

Supreme Court of the United States

October Term, 1982

HORMOZ SABET,

Petitioner,

- against -

AMERICAN EXPRESS INTERNATIONAL BANKING CORP.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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(12521)

QUESTIONS PRESENTED FOR REVIEW

1. Does the Federal Magistrates Act, 28 U.S.C. § 636(b)(1)(1977), require the District Court to review the record of an evidentiary hearing held before a United States Magistrate upon appeal to the District Court from the Magistrate's Report and Recommendation or, in the absence of any record, to rehear the testimony?

2. Does a District Court have jurisdiction over an action by a New York bank against an Iranian guarantor of a loan to an expropriated Iranian corporation when the United States and Iran have entered into a treaty which provides:

> "An International Arbitral Tribunal (the Iran-United States Claims Tribunal) is hereby established for the purpose of deciding claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim which arises out of the same contract, transaction or occurrence that constitutes the subject matter of that national's claim, if such claims and counterclaims are outstanding on the date of this agreement, whether or not filed with any court, and arise out of debts, contracts (including transactions which are the subject of letters of credit or bank guarantees), expropriations or other measures affecting property rights . . . ."?

3. Do settled statutory and common law precepts (a) mandate the discharge of co-obligors and guarantors where the outstanding obligation has been satisfied, and (b) compel the discharge of obligors where collateral has been impaired or retained?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Justices of the Supreme Court of the United States:

Petitioner Hormoz Sabet respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit affirming the summary judgment entered against petitioner by the United States District Court for the Southern District of New York.

OPINIONS BELOW

The opinions of the Court of Appeals are not reported and are set forth in Appendix A, infra at A-1 , et seq. The Statement on Remand from the Court of Appeals, the opinions of the District Court, and the Report and Recommendation of the United States Magistrate are set forth in Appendix B, infra at B-5 , et seq.

PARTIES

The plaintiff in the courts below was American Express International Banking Corp. ("AMEX"), a New York banking corporation and a subsidiary of American Express Company. Defendant Hormoz Sabet is an Iranian citizen.

JURISDICTION

While the courts below initially had jurisdiction on the basis of diversity of jurisdiction, it is respectfully submitted that they were divested of jurisdiction by virtue of the Iran-United States Agreements and this Court's decision in Dames & Moore v. Regan, 453 U.S. ___, 101 S.Ct. 2972 (1981).

STATEMENT OF THE CASE

A. The Loan Transcations and the Pledged Shares

In 1977 and 1978, AMEX made four loans totalling $4 million to Habib Sabet for use by Firooz Corporation ("Firooz"), an Iranian company controlled by the Sabet family, but expropriated by the Iranian government during the hostage crisis. Hormoz Sabet cosigned and guaranteed the loans. The loans were collateralized by 150,000 shares of stock in the Industrial and Mining Development Bank of Iran ("IMD Bank"). Firooz and another Sabet family corporation, Iramoz Corporation ("Iramoz"), executed Pledge Agreements and posted the collateral on behalf of the Sabets. Payments of principal and interest and the repayment of one entire loan were made until Iranian exchange controls made it impossible to obtain

the currency needed to repay AMEX, thereby leaving a balance of $3,232,930 owed to AMEX.

B. The Political Crisis in Iran and the Sabets' Instructions to Sell the Pledged Shares

In December 1978, and thereafter from January 1979 through April 1979, the Sabets urged AMEX to sell the pledged shares in order to satisfy the outstanding obligations and to guard against the diminution in the value of the collateral, in view of the political and economical turmoil in Iran which culminated in the taking of the American hostages. AMEX did nothing. Had AMEX sold the collateral in January 1979, it would have realized $3,462,857, a sum more than sufficient to satisfy all outstanding obligations to AMEX.

After the new regime came to power in early 1979, it confiscated and na-

tionalized the Sabets' assets including Firooz and Iramoz. In June 1979, the Teheran Stock Exchange finally closed and with it, the market for IMD Bank shares. Hence, from December 1978 through June 1979, AMEX did nothing to protect the value of the collateral. No court has ever required AMEX to explain this failure or even to account for the whereabouts of the shares.

C. Prior Proceedings

In July 1979, AMEX commenced an action in New York State Supreme Court against Habib Sabet, Iradj Sabet, Hormoz Sabet and Firooz Corporation, wherein AMEX moved for summary judgment in lieu of complaint. The action was removed by defendants to the United States District Court for the Southern District of New York.

Hormoz Sabet defended against AMEX's motion on the grounds that he was never properly served with process and that, pursuant to protections afforded by the Uniform Commercial Code, AMEX's treatment of the collateral constituted (a) a foreclosure on the collateral, or (b) an impairment of the value of collateral, either action releasing Hormoz Sabet from liability.

On August 29, 1980, the District Court granted summary judgment against the defendants on the grounds that the defenses of the Uniform Commercial Code regarding AMEX's retention or impairment of the collateral were not available to non-owner obligors. (B 27 - 60).

The District Court, however, noted that a dispute existed as to whether Hormoz Sabet had been personally served and referred the matter to a United States Magistrate for an evidentiary

hearing.

On October 8 and 31, 1980, the Magistrate conducted hearings on AMEX's claim of personal service. AMEX's process server was shown to be "unclear", "imprecise" and inconsistent, in the words of the Magistrate. Further, contradicting AMEX's process server, Sabet and his attorney testified that Sabet was not even at the location where the process server claimed to have served him. The Magistrate nonetheless held that Sabet had failed to disprove the process server's claims and hence that process was validly served. On February 10, 1981, the Magistrate issued a Report and Recommendation containing fundamental errors of fact and contradictory conclusions. (R 5- 16).

On February 20, 1981, pursuant to 28 U.S.C. § 636(b)(1), Hormoz Sabet objected to the Magistrate's report and

requested the District Court to make the statutorily required "de novo determination", i.e., to review the record or, if there is no record, to rehear the brief testimony.

On April 6, 1981, without having reviewed any record of the proceedings before the Magistrate (since the testimony was not stenographically recorded), and without having listened to a tape recording of the proceedings, the District Court summarily affirmed the Magistrate's report. Thus, the District Court failed to make the appropriate "de novo determination".

In so doing, the District Court overlooked the serious error made by the Magistrate in assessing the testimony, namely that Hormoz Sabet testified that he was at his attorney's offices at the time of the alleged service and that "[his attorney] confirmed this", as well

as the fact that Sabet could not have departed unnoticed from his attorney's offices. This testimony was reiterated by Sabet's attorney in an affidavit submitted on February 25, 1981. The District Court then compounded the Magistrate's error when it erroneously assumed that Sabet's attorney "did not attempt to present this testimony at the hearing where he would have been subject to cross-examination and where his demeanor could have been observed and his credibility assessed . . . ." As Sabet's attorney stated in his affidavit, he did in fact appear and testify on direct and cross to precisely these facts at the hearing.

The court went on to note that "[Sabet's attorney] does not indicate at what time during the 'afternoon in question' Sabet arrived at [his attorney's offices] or specify that [he] saw

or spoke to Sabet at or around 2:55 . . . ." The District Court's findings are flatly repudiated by both (a) the Magistrate's Report which explicitly states that Sabet's attorney's testimony confirmed the fact that Sabet was at his attorneys at 2:55 P.M. on the day in question, and (b) Sabet's attorney's affidavit in which he affirms that Sabet was in an adjacent conference room during the brief periods that they were apart and that Sabet could not have left the offices without his attorney having noticed, as well as the fact that he had so testified at the hearing.

On April 15, 1981, the District Court entered judgment against Hormoz Sabet. An appeal to the United States Court of Appeals for the Second Circuit was thereafter taken.

On Decmeber 10, 1981, at the commencement of oral argument before the United States Court of Appeals for the Second Circuit, the Court observed that, with respect to the issue of the validity of service and the requirements of a "de novo determination", it wished to know whether the District Court had listened to a tape recording of the proceedings before the Magistrate. Accordingly, the Court adjourned all argument and remanded the case to determine whether or not the District Court had listened to the tape.

On December 23, 1981, the District Court filed its Statement of Remand, acknowledging that it had not listened to the tape recording of the proceedings before the Magistrate. The Court stated that, while it was the Magistrate's custom to retain the tape for 10 to 20 days after the Report is issued, since

AMEX's objections to the Report did not contain a specific request that the court listen to the tape, she erased the tape before the District Court began its review of AMEX's objections. Thus the possibility of an actual review of the proceedings before the Magistrate was eliminated. The District Court acknowledged that Sabet requested it to make a "de novo determination", but stated that Sabet never suggested that it should listen to the tape.

On April 5, 1982, the Second Circuit summarily affirmed the decision of the District Court noting that they had examined the District Court's "statement" pursuant to their remand and that it had considered oral argument when in fact no oral argument was ever had by the parties as to any issue.

D. The Iran-United States Agreements

The five agreements which were signed on January 19, 1981, thereby concluding the Iranian crisis ("Iran-United States Agreements"), were transmitted to Congress on March 12, 1981, and were upheld by this Court in Dames & Moore v. Regan, 453 U.S. ___, 101 S. Ct. 2972 (1981). This Court specifically upheld the Iran-United States Agreements insofar as they (a) "terminate[d] all legal proceedings in United States courts involving claims of United States . . . institutions against Iran . . . ." and (b) established the International Arbitral Tribunal (the Iran-United States Claims Tribunal) as the exclusive forum to resolve all claims by a U.S. institution and any Iranian entity or national.

In addition, one of the agreements established two funds (Dollar Account

No. 1 and Dollar Account No. 2), against which banking institutions could make claims for unpaid loans as follows:

DOLLAR ACCOUNT NO. 1

Dollar Account No. 1 (as it was subsequently called) was used to pay principal and interest on all loans made by banking syndicates of which U.S. banks were members. All such syndicated bank loans have been fully paid and satisfied. The balance of Dollar Account No. 1 is available to satisfy non-bank claims in the arbitral tribunal in The Hague, Netherlands. Iran has agreed to replenish this fund under certain circumstances.

DOLLAR ACCOUNT NO. 2

Other funds totalling $1,418 billion were transferred to, and are now retained by, the Bank of England

> "for the purposes of paying the unpaid principal and the interest owing, if any . . . on all other indebtedness held by United States banking institutions of, or guaranteed by the Government of Iran, its agencies, instrumentalities or controlled entities not previously paid . . . ."

These funds are known as "Dollar Account No. 2".

Dollar Account No. 2 is available for claims of United States banks only. The balance of the fund must be returned to Iran. As of March 1982, accrued interest on Dollar Account No. 2 exceeded $300 million. Dollar Account No. 2 thus consists of more than $1,718 billion.

Approximately 40 United States banks (which were not participants in syndicated loans) including AMEX filed claims against Dollar Account No. 2. Their claims totalled approximately $700 million. It is thus obvious that ample

funds exist to pay all claims by all American banks concerned and that in any event, there is little doubt that AMEX's claim against Firooz is completely compensable by Dollar Account No. 2.

REASONS FOR GRANTING THE WRIT

I

THE COURT OF APPEALS ERRED IN SUMMARILY AFFIRMING THE JUDGMENT OF THE DISTRICT COURT, BECAUSE THE DISTRICT COURT DID NOT COMPLY WITH THE REQUIREMENTS OF THE FEDERAL MAGISTRATES ACT WHEN IT FAILED TO REVIEW THE RECORD OF THE EVIDENTIARY HEARING BEFORE THE MAGISTRATE OR TO REHEAR THE TESTIMONY

The Federal Magistrates Act provides that upon timely written objection to the magistrate's findings, a judge "shall make a de novo determination" with respect to those portions of the magistrate's findings to which objection is made. 28 U.S.C. § 636(b)(1).

It is well settled that a "de novo determination" requires the district

court to review the complete record of the hearing before the magistrate, i.e., the transcript or a tape recording. United States v. Lewis, 621 F.2d 1382, 1387 (5th Cir. 1980), cert. denied, 101 S.Ct. 1400 (1981); United States v. Marshall, 609 F.2d 152, 155 (5th Cir. 1980); Bowman v. Bordenkircher, 522 F.2d 209, 210 (4th Cir. 1975); Campbell v. United States District Court for the Northern District of California, 501 F.2d 196, 206 (9th Cir.), cert. denied, 419 U.S. 879 (1974); Reed v. Board of Election Commissioners of the City of Cambridge, 459 F.2d 121, 123 (1st Cir. 1972).

In the instant action, there was no transcript of the proceedings and the District Court failed to listen to the tape recording which no longer exists. Instead, the court relied on the erroneous report of the Magistrate and

thereby compounded the Magistrate's errors by, e.g., finding that Sabet's attorney did not give crucial testimony which he both did give and so stated in a subsequent affidavit.

In the absence of a complete record with which to make the required "de novo determination" the District Court was obligated to rehear the brief testimony. See United States v. Raddatz, ___ U.S. ___, 100 S.Ct. 2406 (1980). The Federal Magistrates Act is a relatively new statute. Guidance from this Court is necessary as to its proper meaning and application.

II

THE COURT OF APPEALS ERRED IN FAILING TO FIND THAT PURSUANT TO THE IRAN-UNITED STATES AGREEMENTS AND THE RECENT DECISION OF THIS COURT, UNITED STATES COURTS LACKED JURISDICTION TO ENTER JUDGMENT AGAINST AN IRANIAN NATIONAL

The Iran-United States Agreements

conferred exclusive jurisdiction on the Iran-United States Claims Tribunal of any claim between a United States "institution" and an Iranian "national".

The District Court below entered judgment against an Iranian citizen. The Second Circuit refused to set aside the judgment. The courts below were ousted of jurisdiction, and the judgments below should be vacated. Dames & Moore v. Regan, 453 U.S. ___, 101 S.Ct. 2972 (1981).

A determination requiring AMEX to claim only pursuant to the mechanism set forth in the Iran-United States Agreements is especially appropriate, because AMEX's claim is against Dollar Account No. 2, which is fully and excessively funded. Dames Moore's claim was against Dollar Account No. 1, which may have to be replenished when exhausted.

The Iran-United States Agreements provided for the full and complete funding of Dollar Account No. 2. That fund consists of more than $1,718 billion. Claims of United States banks with non-syndicated loans are only about $700 million. The Iran-United States Agreements clearly provided that Dollar Account No. 2 was the exclusive mechanism for American banks to satisfy their claims against Iranian nationals. While non-bank claimants do not have their claims fully funded, bank claimants do have all of their claims fully funded.

Therefore, there are even more compelling reasons to require AMEX to comply with the Executive Orders and Agreements which this Court upheld in Dames & Moore v. Regan than existed when this Court required Dames & Moore thus to comply.

III

THE COURT OF APPEALS ERRED IN FAILING TO FIND BOTH THAT (A) THE SATISFACTION OF OUTSTANDING OBLIGATIONS, AND (B) IMPAIRMENT OR RETENTION OF COLLATERAL DISCHARGES THE OBLIGOR

AMEX was never required to explain what it did with the collateral, nor was defendant ever permitted discovery with respect to this matter. It is a fundamental principle of the law of suretyship that the satisfaction of the outstanding obligation discharges the surety. A. Stearns, Law of Suretyship, §§ 6.42, 6.52 (5th Ed. 1951); 72 C.J.S. Principal And Surety, §§ 140, 142 (1951).

AMEX has satisfied the outstanding obligations by its retention of the collateral, thus exonerating Hormoz Sabet from liability as a guarantor. Moreover, the satisfaction of the obligation discharges a co-obligor. Gilleran v. Owens,

182 App.Div. 580, 169 N.Y.S. 958, 959 (1st Dep't 1918); Ross v. Worth Electric Supply Co., 100 Misc.2d 1058, 420 N.Y.S. 2d 441, 443 (New York County 1979).

This principle is codified in New York General Obligations Law § 15-103 (McKinney 1978), which provides:

> "The amount of value of any consideration received by the obligee from one or more of several obligors, or from one or more of joint, or of joint and several obligors, in whole or in partial satisfaction of their obligations, shall be credited to the extent of the amount received on the obligations of all co-obligors to whom the obligor or obligors giving the consideration did not stand in the relation of a surety."

In the instant action, the pledge of the shares as collateral was made by Firooz and Iramoz to secure the loan of Habib Sabet. Upon default, the pledged collateral was available to AMEX. The pledgors therefore were not in a relation of surety to Hormoz Sabet, but were

simply co-obligors whose satisfaction of the outstanding debt must be credited to Hormoz Sabet.

In addition, this principle that satisfaction of the obligations discharges Sabet's liability is accorded recognition by the tenets of the Uniform Commercial Code § 3-601(2)(McKinney 1964). Section 3-601(2) provides that

> "Any party is also discharged from his liability on an instrument to another party by any other act which would discharge his simple contract for the payment of money." [Emphasis supplied]

AMEX's satisfaction of the obligations by use of the collateral discharges Sabet and, in any event, raises material issues of fact which preclude a grant of summary judgment. At a minimum, discovery is necessary to resolve this question.

Section 3-606(1)(b) of the New York Uniform Commercial Code (McKinney 1964) ("UCC"), provides that:

> "The holder discharges any party to the instrument to the extent that . . . the holder unjustifiably impairs any collateral for the instrument given . . . on behalf of the party . . . ."

In construing the section of the UCC covering the impairment of collateral and the reference to "any party", the New York Court of Appeals noted that the UCC had expanded the scope of the "old Negotiable Instruments Law which referred only to the discharge of persons secondarily liable on the instrument" to include primary obligors. Indianapolis Morris Plan Corp. v. Karlen, 28 N.Y.2d 30, 34, 319 N.Y.S.2d 831, 834 (1971). Subsequently, Mikanis Trading Corp. v. Block, 59 App.Div.2d 689, 690, 398 N.Y.S. 2d 679, 681 (1st Dep't 1977) assured that accomodation parties such as Sabet may

complain of unjustifiable impairment of collateral. In addition, Mikanis refused to limit this defense to accomodation parties and thus it is equally applicable to guarantors.

Hormoz Sabet, as a co-signer, and therefore an accomodation party and a guarantor, is a party who is secondarily liable and under Karlen was discharged by AMEX's unjustifiable impairment of collateral.

IV

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

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